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Economic Conditions Government Finance

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General Business Conditions

THE effects of a Korean truce on the economic situation have been the subject of speculation for many months. Now that the truce has been signed, the uppermost feeling is one of rejoicing that the bloodshed has ceased and the cost and waste of active warfare have ended. Here or abroad, markets were scarcely affected. Some had expected that the signing would promote bearish sentiment and cause buyers to hold off, but that possibility evidently was foreseen and discounted some time ago.

Unlike Armistice Day in 1918 or V-E and V-J days in 1945, the truce does not mark the conclusion of a world conflict, but only the end of actual combat in one area of that conflict. It will not be followed by demobilization, or pose any considerable problems of reconversion. Nor will it make possible more than a modest reduction in the defense program which this country must maintain. It is not even assurance of lasting peace in Korea itself, and its long-run value therefore cannot be appraised until the political conference scheduled for the fall has been concluded. For all these reasons, the verdict of the markets is that the truce is not a dominant influence in the business outlook.

CONTENTS

To be sure, the end of the fighting will require some adjustments. There is now less need for ammunition and other items expended in combat. The movement of goods and personnel to the Far East may be smaller. On the other hand, the troops will have to be maintained, and relief and rehabilitation for Korea, drawing on this country for supplies, will go forward.

Fundamentally, a bearish interpretation based on the truce would assume that maintenance of business activity in this country is dependent upon continuation of non-productive expenditures. This assumption will not stand analysis, in light of reason or of experience after other wars. Business depends, in the end, upon the enterprise and ambitions of people; upon their willingness to work in order to raise their standard of living; upon research and technological progress; upon saving and investment; upon good management of public and private affairs; upon cooperation and understanding to maintain fair and equitable terms for the exchange of goods and services; and, finally, upon peace, order, and stability.

Business on a High Plateau

In general, business is holding on the high plateau of earlier months. The demand for goods and services which supported trade and industrial activity at record levels during the spring has shown few signs of faltering. Retail sales in June were 6 per cent above a year ago, and by all signs July again has made a good showing. Retail sales have been remarkably stable through the year to date; from month to month, allowing for seasonal differences, they have varied less than 1 per cent, and the gains over last year have been made by all types of stores. The upward trend of consumer buying since last fall

is closely tied to the rise in personal income, which is running about 7 per cent higher than last year. In the months ahead, this rate of increase can be expected to slow down, inasmuch as little further growth in production and employment can occur. More modest gains in retail sales are likely to be the result. The signs, however, are more indicative of a leveling out or a spotty slackening, such as the expected seasonal drop in automobiles, rather than any general decline.

Buying has remained brisk, too, at the industrial level. Overall manufacturers' orders have turned down slightly, but only about as much as seasonally expected. Order backlogs for steel are not appreciably smaller than they were several months ago. Orders for bulk chemicals are also holding up well in spite of the buying flurry that took place before the price advances last quarter. The position of the cotton textile market is strong; a large portion of print cloth output, for instance, is sold for the rest of this year.

On the production side, industrial output remains close to the record level of earlier months, after allowing for the usual vacation declines in some industries. Paperboard, textiles, and steel have all had dips, but operations quickly picked up again. With seven months gone, 1953 is almost sure to set a record, both in volume and value, of goods and services produced.

Commodity prices, as measured by the weekly wholesale price index of the Bureau of Labor Statistics, during July reached the highest of the year. Early in the month prices of farm products were notably weak, but a strong rally led by livestock and animal products and by wheat has brought the indexes up again, while further increases have been posted in some non-agricultural commodities. The consumer price index (cost of living) for June set a new high by a narrow margin. These price changes have not been broad enough to represent a departure from the narrowly sideways trend of the past six or eight months, but they indicate that demand is not falling away markedly.

Paradoxes in Business Sentiment

Recent surveys of business expectations, conducted by the National Industrial Conference Board and others, suggest that most business men feel that their own sales prospects are good. On the other hand, much current comment indicates a belief that business as a whole is likely to turn downward. Only in exceptional circumstances could both of these opinions prove correct. Faith in sales prospects helps keep business good. It keeps buying steady, stimulates outlays for new plant and equipment, and encourages vigorous sales promotion. If not carried to extremes of reckless optimism, which is not now the rule, these are the very things which prevent recession.

The case for a recession is generally built on belief that defense requirements are waning, but industrial capacity, although it is already large enough to meet all military and civilian requirements, continues to grow. Furthermore, consumer demands for durable goods are rapidly being filled. Hence, a falling off of production and incomes will result. This reasoning is supported by reference to economic trends which include the following:

1. Industrial production is no longer expanding.

2. Farm prices and farm income have turned downward.

3. Construction contract awards have begun to decline.

4. The automobile industry has been operating at a rate which cannot be sustained all year.

5. Reduction in auto and appliance production, and cessation of inventory accumulation, will reduce steel operations.

6. The Government is cutting defense expenditures.

7. Inventories, which have increased greatly, may need to be whittled down.

8. Debt has been increasing rapidly, particularly consumer debt, and a slackening in borrowing would slow down buying.

When marshalled in this way these citations are impressive. For the most part they are facts of record. Their interpretation, however, and the degree to which business may be affected, still remain matters of opinion. There is little significance, for example, in the fact that industrial production is no longer expanding, for production in the aggregate is at the practicable ceiling, which is set primarily by the labor supply. Unemployment is below what most authorities consider normal and overtime work is common. The conclusion is that there are scarcely any able workers left to employ.

The decline in prices of farm products, which by the latest figures were some 12 per cent below a year ago, has more than offset a larger volume of farm marketings this year, and in the first six months farmers' cash receipts from marketings were 5 per cent below the corresponding 1952 figure. The depressing effects on farm purchasing power are particularly marked in the drouth areas.

Building contract awards also have been running below last year, and lately have shown

more than a seasonal drop. The automobile manufacturers, if present production plans hold, will turn out close to 5 million passenger cars by the end of the third quarter. When this is compared with sales estimates of 5,500,000 to 6 million for the entire year, it becomes apparent that fourth quarter production is likely to be well below present rates.

If Recession, How Much?

These are indications that something may be subtracted from current activity before the year is out, but the question is, how much? Evidently farmers will give less support than last year to general business activity. On the other hand, urban consumers so far have given more support, and the drop in farm income has not checked the rise in aggregate personal income and buying power. Farm income, adjusted for changes in prices paid in order to measure farm purchasing power, reached its peak in 1947; it has declined moderately since, but the drop has not prevented expansion of general business to new record levels. Farm income is still high by historical comparisons.

Building expenditures, as distinct from contracts awarded, have run steadily at record levels, and the total volume of work projected assures continued high activity even if there is some drop from the spring peak. Lower automobile production later in the year will cut buying power of the people engaged in the industry, and those selling to it, but it is less likely to lead to widespread unemployment than some may think. A General Motors spokesman has estimated that overtime represents 15 per cent of the hours worked during this period of record production. The first impact of a slowing down may be reduction of overtime rather than large-scale layoffs.

A reduction in the output of automobiles and appliances in the fourth quarter would not of itself have a decisive effect on steel operations. Automobile manufacturers took 16 per cent of steel output in 1952 and appliance manufacturers only 2½ per cent. Curtailment in these lines would reduce requirements for steel by only a few percentage points. The continuing good demand for steel, with order books now filling into the fourth quarter, has strengthened the opinion that any drop toward the end of the year will be moderate.

For a year and a half a cut in defense spending has been regarded as a prime reason for expecting a recession. The argument would have more force if defense spending had been built up in the last few months to the peak once expected. However, the actual trend has been more nearly level, and reductions and economies can hardly be prime factors in cutting defense work for some time to come. By present indications, the annual rate of defense spending is unlikely to drop by more than $3 billion in the current fiscal year.

As the defense industries make deliveries against their unfilled orders, their inventories will be worked off. Reduction of this kind, however, does not signify forced selling and price cutting. Among other important lines, it would be hard to find many in which it could be shown that inventories are larger than are needed to carry on present production and sales. They will be large if sales turn down greatly, but it is uncertain when that will be.

Constant Need for Cost Reduction

A description of the prospect in these terms emphasizes the points where some slackening may be expected, but leaves many supporting factors to be taken for granted. Primarily, the supports are the immense demands of the American people and the ability of the productive organization to satisfy them efficiently, reinforced by the enterprise of management in spending to improve productive facilities, to reduce costs and to bring in new products. The principal requirement for keeping business going is to maintain fair and equitable terms of trade, i.e., to keep down costs through economical operation and high productivity and to set selling prices at levels which will move goods.

The strengthening of competitive pressures now so widely noted, as producers try to move into new markets or to obtain a larger share of old ones, tends to force more economical and efficient operation and to reduce unit costs, which in turn provides the basis for expanding markets by lowering prices or improving the product. Cost reduction makes more rapid headway in time of recession, which causes the failure of marginal firms and the unemployment of marginal workers; but on the other hand steady progress in cost-cutting by increasing productivity may be effective in averting recession. Thus in a very real sense cost-cutting may be an alternative to recession. Some industries during the past two years have gone through a period of more competitive selling and cost-cutting, and now are in a stronger position accordingly.

Business always is confronted by this challenge. The farm machinery industry today faces a market whose buying power is decreasing; other durable goods manufacturers, by contrast, still face consumers (farmers excepted) whose incomes are rising. The challenge to the farm

machinery industry therefore is already pressing. One way in which it seeks to keep up production and sales is to broaden its lines as well as to improve them. In particular, the implement manufacturers are promoting equipment especially designed for the small-acreage farm. About 40 per cent of farm work is still done by hand, and mechanization has not progressed as rapidly on small farms as on large ones. The small farmers will have to be sought out and sold, but the possibilities of labor-saving and cost-cutting ought to be persuasive.

There are always needs to be met. The problem is to produce goods to meet them at costs and prices which will keep goods moving. The indications of some slackening in industrial operations toward the end of the year give a new urgency to this problem. More is involved than the ability of companies to compete with each other, though that may seem the most pressing matter to management. The broader question is the relation of costs and prices in the industries to the incomes of buyers of industrial products. It is a question of industrial wage rates — which are an element in costs and prices as well as in purchasing power — in relation to the "wage rates", or the equivalent, of farmers and other non-industrial workers. The economy makes progress and enjoys stability only when the terms of trade are balanced, so that trade can go forward.

Half Year Corporate Earnings

Corporate statements issued during the past month show in most cases that both sales and net income for the first half year increased over the same period of 1952. The favorable comparisons reflect the higher level of trade and productive activity this year. The first half of 1952 — the second quarter in particular — was a period of relative slackness in business, as compared with 1953. Consumer goods industries were still in the last stages of the inventory reduction which had set in during 1951, and the steel strike curtailed industrial output.

By contrast, 1953 to date has seen record, or near-record, activity in residential construction, in business outlays for new plant and equipment, in road building and public works, and in the production of steel, automobiles, television sets, household appliances, and numerous types of other durable goods. At the same time, a marked pickup has taken place in the output of the textile, apparel, shoe and numerous other consumer goods industries.

In many cases an additional factor in earnings improvement has been increased selling prices, including steel, copper, automobiles, household appliances and gasoline, as well as some foods, cigarettes, and textiles. In 1952 profit margins in many lines were squeezed between rising costs and fixed selling prices. However, profit margins in the aggregate, as expressed in percentages of the sales dollar, have been no higher in 1953 than in 1952.

Federal taxes on income, including the excess profits tax which expired by law on June 30 but later was extended by Congress to December 31, 1953 absorbed 62 per cent of the operating earnings, compared with 59 per cent in 1952, and of course took a much larger portion of the increases in earnings realized this year. Reenactment of the excess profits tax increased the first quarter tax liability of some companies beyond the amount that had been accrued in their statements, making it necessary for them to catch up on the deficiency either by an extra charge against the second quarter earnings, or by a revision of the first quarter figures previously issued. Adjustments in connection with such high tax rates often distort the net income as shown by interim figures.

17 Per Cent Increase

Our tabulation of 550 reports published to date, representative for the most part of the larger manufacturing organizations but comprising also a limited number in the mining, trade, and service industries, shows a combined net income of approximately $2,759 million after taxes in the first half year, which is 17 per cent above the corresponding period of 1952. For the second quarter this year alone, net income of $1,433 million was 8 per cent above that of the first quarter, and 26 per cent above the second quarter of 1952. Over two out of three companies showed gains over last year in both the second quarter and the first six months. The recent trend of earnings is indicated by the following quarterly totals, while a condensed summary by major industry groups is given in the table on the next page.

Net Income After Taxes of 550 Leading Corporations
(In Millions of Dollars)

	1951	1952	1953
First quarter	$1,378	$1,210	$1,325
Second quarter	1,357	1,140	1,433
Third quarter	1,150	1,158	—
Fourth quarter	1,398	1,557	—

The steel industry shows a sharp gain in its comparative figures, particularly for the second quarter, because of the shut-down last year caused by a strike that lasted eight weeks and carried into the third quarter.

Most of the other groups that made the sharpest percentage gains in the first half of this

NET INCOME OF LEADING CORPORATIONS FOR THE SECOND QUARTER AND FIRST HALF YEAR

(In Thousands of Dollars)

No. of Cos.	Industrial Groups	Reported Net Income Second Quarter 1952	Reported Net Income Second Quarter 1953	Per Cent Change†	Reported Net Income Half-Year 1952	Reported Net Income Half-Year 1953	Per Cent Change
28	Food products	$ 28,435	$ 32,751	+ 15	$ 58,818	$ 71,166	+ 21
12	Beverages	12,242	13,587	+ 11	22,430	23,709	+ 6
11	Tobacco products	11,835	13,609	+ 20	20,893	25,231	+ 21
24	Textiles and apparel	13,322	18,797	+ 41	29,500	39,548	+ 34
28	Paper and allied products	22,956	25,481	+ 11	47,079	49,925	+ 6
31	Chemical products	126,128	151,056	+ 20	254,340	290,588	+ 14
15	Drugs, soap, cosmetics	14,626	14,370	— 2	32,152	31,954	— 1
26	Petroleum producing and refining	344,237	378,024	+ 10	701,013	733,478	+ 5
23	Cement, glass, and stone	47,792	54,865	+ 15	86,939	99,325	+ 14
37	Iron and steel	59,755	181,633	+ —	192,711	343,808	+ 78
17	Building, heating, plumbing equipment	10,875	14,666	+ 35	20,717	25,559	+ 23
21	Electrical equipment, radio, and television	54,112	77,411	+ 43	112,527	147,344	+ 31
40	Machinery	33,248	33,146	— 0	62,199	64,630	+ 4
12	Office equipment	16,374	18,215	+ 11	34,554	35,570	+ 3
12	Automobiles and trucks	157,378	172,985	+ 10	294,541	334,279	+ 13
24	Automobile parts	24,208	28,500	+ 18	48,157	55,824	+ 16
11	Railway equipment	13,412	15,868	+ 18	27,243	28,011	+ 3
73	Miscellaneous metal products	81,966	110,652	+ 35	169,959	215,309	+ 27
39	Miscellaneous manufacturing	26,124	30,210	+ 16	49,771	57,010	+ 15
484	Total manufacturing	1,098,510	1,385,826	+ 26	2,265,543	2,672,268	+ 18
26	Mining and quarrying	24,095	26,895	+ 12	51,625	47,534	— 8
26	Trade (retail and wholesale)	8,594	11,225	+ 31	15,728	20,984	+ 33
14	Service and amusement industries	8,445	9,515	+ 13	16,459	18,164	+ 10
550	Total	$1,189,644	$1,433,461	+ 26	$2,340,355	$2,758,950	+ 17

† Increases or decreases of over 100% not computed.

year were the same that experienced the sharpest decreases a year ago, such as textiles and apparel, building equipment, electrical apparatus, and miscellaneous metal products.

Sales billed by the 484 manufacturing companies that to date have reported for the half year reached an aggregate of approximately $49 billion – 18 per cent above the same period of 1952. A condensed summary of their operations, partly estimated, is given below.

Sales and Net Income of 484 Manufacturing Corporations in the First Half Year

(In Millions of Dollars)

	1952	1953	Change Amount	Change %
Receipts from sales, etc.	$41,753	$49,376	+7,623	+18
Total costs, except taxes	36,291	42,317	+6,026	+17
Balance before taxes	5,462	7,059	+1,597	+29
Federal income & e. p. taxes	3,196	4,387	+1,191	+37
Net income after taxes	2,266	2,672	+ 406	+18
Taxes to balance before taxes	59%	62%		
Net income per sales dollar	5.4c	5.4c		

It will be seen that the substantial gain in sales for the half year kept somewhat ahead of the persistent upward trend in operating expenses, so that the balance before taxes increased by 29 per cent. Reserves for federal income and excess profit taxes increased by 37 per cent.

Net income after taxes increased by 18 per cent. The rise was due almost entirely to the expansion in dollar sales, inasmuch as the average net profit margin per sales dollar of 5.4 cents was unchanged.

Continued Rise in Dividends

The recovery in earnings this year aided corporations in maintaining the long-term upward trend of dividend payments that has prevailed over the past ten years. Publicly reported cash dividend payments in the first half year were approximately 4 per cent above the first half of 1952, according to the compilations by the Department of Commerce. Part of the increase reflected higher rates per share, and part the greater number of shares now outstanding.

Dividends in the manufacturing industries, which make up over half of the grand total, were up 2 per cent. There were considerably sharper increases in some branches, including electrical and other machinery, transportation equipment except automobiles, and oil refining, but decreases in textiles and leather, and little change in paper and printing or in nonferrous metals. Disbursements were up 9 per cent in the railroad group, 13 per cent in gas, and 16 per cent in communications.

Dividend changes have turned more favorable this year as measured by the number of declarations also. The number of companies increasing their dividends, or declaring extra dividends, declined in the first half of 1952 but turned upward this year. At the same time, the number of companies reducing their dividends, or omitting them entirely, increased in the first half of 1952 but turned downward this year. Following is the compilation by the New York World-Telegram & Sun:

	First Half Year 1949	1950	1951	1952	1953
Increased dividends	172	344	306	152	259
Extra dividends	491	511	561	402	410
Reduced dividends	132	38	24	34	52
Omitted dividends	117	66	27	34	66

Changes in Working Capital

Corporations have further built up their working capital this year despite the continued heavy investment of funds for improvements to plant and equipment. All corporations in the U.S., except banks and insurance companies, increased their net working capital during the first quarter by approximately $1.3 billion, according to the latest quarterly analysis by the Securities & Exchange Commission. The record total of $86.9 billion reached on March 31, 1953 was more than three times that of prewar 1939. Following are the changes by major current asset and liability items:

Working Capital of All Corporations in U. S., Excluding Banks and Insurance Companies
(In Billions of Dollars)

	Dec. 31 1939	Dec. 31 1945	Dec. 31 1952	Mar. 31 1953
Current Assets				
Cash	$10.8	$21.7	$29.5	$28.1
U. S. Govt. securities	2.2	21.1	21.0	20.1
Receivables, net	22.1	25.9	64.6	65.2
Inventories	18.0	26.3	63.6	65.4
Other current assets	1.4	2.4	2.4	2.5
Total current assets	54.5	97.4	181.1	181.2
Current Liabilities				
Notes & accounts payable	21.9	25.7	60.7	60.2
Federal income taxes	1.2	10.4	16.4	15.2
Other current liabilities	6.9	9.7	18.4	18.9
Total current liabilities	30.0	45.8	95.5	94.3
Net Working Capital	24.5	51.6	85.6	86.9
Ratios:				
Current assets to current liabilities	1.82	2.13	1.90	1.92
Cash & govt. securities to current liabilities	0.43	0.93	0.53	0.51

Although the total of current assets was little changed this year, there was considerable shifting among the different items. Holdings of cash and government securities were drawn down substantially, while inventories and receivables rose to new high levels.

Current liabilities were reduced by $1.2 billion, due largely to the statutory step-up in remittances of U.S. income taxes, 40 per cent of which was payable this year in each of the first two quarters.

The March 31, 1953 ratios of total current assets to current liabilities, and of cash plus governments alone to current liabilities, remained little changed at 1.92 and 0.51, respectively. Although these liquidity ratios stood below the high levels reached during World War II, they held above prewar.

It is significant, however, that maintenance of the liquidity ratios and the gain in dollar total of working capital have been achieved in part at the cost of increasing bonded indebtedness. In the first quarter of this year American corporations, in addition to the $1.3 billion noted above as added to net current assets, invested $5.2 billion in carrying forward their huge programs of expanding and modernizing plant and equipment. To finance this total demand, corporations obtained the major part of the funds, $4.9 billion, from internal sources — retained income and depreciation accruals. Of the $1.7 billion provided by external sources, $1.0 billion was from new bond issues and $700 million from new stock issues.

Treasury Financing

Moving to cover part of its half-year cash borrowing requirements which are estimated to range between $9 and $12 billion, the Treasury opened subscription books Monday, July 6 on an offering of $5½ to $6 billion Tax Anticipation Certificates of Indebtedness dated July 15, running for eight months, and paying a rate of 2½ per cent to maturity on Monday, March 22, 1954. The holder is privileged to turn them in, at par with interest to March 22, to cover income and profits taxes due next March 15.

In accordance with the regular practice established by the Treasury in 1917, to protect the money market from abnormal stringency arising from major government security sales, authorized commercial bank depositaries were permitted to make payment for the certificates by credit to Treasury Tax and Loan accounts. The balances in these accounts, drawn below $2 billion at the close of business July 14, were thus raised on the next day to more than $7 billion, an amount which, along with Treasury deposits with the Federal Reserve Banks, is expected to take care of Treasury deficit requirements for the third quarter.

The certificates, the largest new money offering by the Treasury in peacetime, were favorably received in the market. Although the books were open only one day, total subscriptions exceeded $8½ billion of which $5.9 billion was accepted by the Treasury. Subscriptions up to $100,000 were allotted in full; on larger amounts 67 per cent was allotted but not less than $100,000 in any case. Commercial banks were the heaviest subscribers although some $2 billion subscriptions were entered by nonbank investors, chiefly corporations. Subscriptions from speculators were inconsiderable.

While the Treasury in the past two years has been anticipating taxes by the sale of discount bills sold on an auction system, this is the first time since 1934 that tax anticipation certificates have been offered. The certificate type of obligation was deemed more suitable in light of the size of the funds sought; certificates have a wider appeal than Treasury bills since they offer a specified rate of interest and eliminate guesswork for the subscriber.

The need for the Treasury to borrow against taxes due next spring arises from action by Congress in 1950, in the Mills bill, stepping up the corporate income tax instalments payable in the March and June quarters. Such taxes were formerly payable in four equal instalments of 25 per cent each. The annual step-up this year raised the rate to 40 per cent of last year's tax liability payable in each of the first two quarters of this calendar year, making a total of 80 per cent payable in the first half year and leaving only 20 per cent payable in the second half year. This distortion of the inflow of Treasury revenues causes a gap in the September and December quarters that must be bridged by short-term borrowing.

Bank Underwriting

The new issue was designed to attract banks as temporary underwriters. As a practical matter, it is impossible for the Treasury to raise so much money in a single day without heavy reliance on the banks. It is to be expected that banks will work the certificates off into the hands of corporate and other taxpayers over a period of time as these latter gradually accumulate funds for March 15 tax payments. Thus, ultimately, accumulation of tax reserves will help finance the deficit.

Unless business developments cause the Federal Reserve to take further measures to ease the money market, the pressures of autumn loan expansion and seasonal increase in currency circulation will force banks to sell the certificates over the months ahead and thus accomplish in an entirely natural way a process of redistribution. The Federal Reserve has power to hasten this redistribution, at its own discretion, by acting to increase money market pressures beyond the limits that will arise under other influences.

Apart from the seasonal elements which enter into the present certificate financing, the practice of bank underwriting of major government security issues is an old and familiar one. Under the pegged markets in force from 1942 to 1951, the Federal Reserve Banks indirectly did the underwriting on new Treasury issues, removed all risks, and created a heyday for free riders who in multiplying numbers subscribed for new issues of government securities on insignificant margins to profit on a sure thing. This discreditable era in public finance was ended by the unpegging of the bond market two years ago and by the Treasury's requirement of a 10 per cent deposit with subscriptions. The subscriber today, bank or nonbank, enters his subscriptions only after a careful evaluation of the rate offered against forces that might arise to produce market price depreciation.

Federal Reserve Operations

The initial success of the offering was powerfully assisted by the Federal Reserve's recent policy shifts to ease the acute tension that had developed in the money market during April and May. The Federal Reserve carried forward its Treasury bill purchases, begun on a small scale in May, up to a total of $1.1 billion through July 8. The reductions in member bank reserve requirements released $1.1 billion funds early in July and the authorities appeared to be taking a less critical attitude toward member bank borrowing. As money rates shaped up under these policies the new offering appeared attractive. The 2¼ per cent certificates due February 15, 1954 traded around par and the 2⅝ per cent certificates due June 1, 1954 commanded a premium of ⅛ point or better. Treasury bills traded in a range of 1¼ to 2 per cent. Trading in the tax anticipation certificates, on a when-issued basis, began July 7 at a par level.

It had been expected that the Treasury in any case would cover a substantial part of its borrowing requirements by anticipating March and June revenue surpluses. Last year the Treasury borrowed $4¼ billion on July 1 by a sale of six-year 2⅜ per cent bonds and carried out its tax anticipation borrowings in October and November. The decision in the present instance to reverse the order and do tax anticipation borrowing first was evidently dictated by market conditions.

The bond market appeared to be redeveloping an atmosphere of confidence, as evidenced among other things by recovering prices and lowered offered yields on new corporate and municipal bond flotations. Nevertheless, the point had not been reached where the market could face up to new Treasury bond flotation of any significant size. This state of mind was reflected in the behavior of the thirty-year 3¼ per cent bonds sold May 1. These bonds, on small-lot buying, recovered to a par level on the offered side of the market as early as July 3 but offerings around that level prevented the issue breaking through to a definite premium until July 16 when remaining offerings at par were absorbed. By the end of the month the 3¼s were quoted at a premium of ⅛ point.

Foreign Gold and Dollar Holdings Growing

Since the growth of currency reserves abroad was discussed in these pages last March, foreign countries have continued to add substantially to their aggregate gold and dollar holdings. From the end of March to mid-July the U.S. gold stock declined only moderately by some $300

million, but more newly mined gold is finding its way into official reserves abroad. With international tensions somewhat relaxed, there has been a slackening in the private demand for gold as a hedge against the risks of war. Meanwhile foreign-owned short term dollar assets, which the U.S. Treasury reported above the $9 billion mark for the first time at the end of April, probably have continued to grow.

The present rise in foreign-owned gold and dollar assets began in the spring of 1952. The upturn was caused both by heavy U.S. outlays abroad and by measures on the part of other nations to live within their means and to enhance the stability of their currencies. From the end of March to the end of December 1952, foreign countries added nearly $1.5 billion to their gold and dollar holdings. They gained an additional $750 million during the first quarter of 1953, according to the Department of Commerce, or almost half as much as during the previous nine months.

Recently the National Foreign Trade Council expressed the opinion that for the full year 1953 foreign countries might gain from $2 to $2½ billion in reserves on the basis of transactions with the United States alone, provided no radical changes take place in political and economic conditions abroad. Retention of newly-mined gold could add another $350 to $400 million.

U.S. Government Outlays Overseas

In general, the conditions which reversed the trend of foreign gold and dollar reserves in the spring of 1952 continue to prevail. Despite a drop in our economic aid to foreign countries and some falling off in the rate of our long- term investment overseas, our international transactions continue to supply foreign countries with a gross amount of some $20 billion a year. As will be seen from the accompanying table, the outflow of dollars has never been higher. Not only are we spending more than ever for merchandise imports, despite declines in price, but U.S. Government spending is the highest since 1949. Over and above military and economic assistance, it is running at the rate of $3¼ billion a year, to which is added economic aid of roughly $2 billion. If military assistance, now running at the rate of nearly $5 billion, were also included, U.S. Government spending abroad would be by far the highest on record, but except where equipment is procured abroad rather than in the U.S. this aid does not actually make dollars available to foreign countries.

An important part of "non-aid" Government spending falls under the heading of merchandise imports for U.S. Government account, estimated this year at about $1.1 billion. Most of these so-called imports never actually reach the U.S., and hence are not included in the regular trade statistics. The item includes purchases of foodstuffs and other goods for our troops abroad, commodities bought under our stockpile programs, and payments for offshore procurement of military goods for our own armed services or under our commitment as a member of the NATO forces. Another $2 billion or so is being spent this year by the U.S. Government to pay for such foreign services as maintenance of our bases abroad, pay of overseas troops, and cost of our diplomatic representation.

Foreign countries in the aggregate are currently adding more to their gold and dollar holdings than the total being disbursed to them in the form of U.S. economic aid, indicating that their dollar transactions would still show a positive balance were the aid eliminated. But the margin would not be large, and if other U.S. Government outlays abroad were also to recede much, the dollar gap would reappear and foreign gold and dollar reserves would again be under pressure. No substantial change in the rate of U.S. Government spending abroad is anticipated this year; still, some countries such as France, Italy, and Greece, which are dependent upon economic grants-in-aid, or Japan and even Germany, which are dependent upon other types

U. S. Transactions Supplying Dollars

(In Billions of Dollars)

	Private (non-Government) Transactions				U. S. Government Transactions						
	Merch. Imports	Services (c) (d)	Capital Outflow	Sub-Total	Merch. Imports	Services (c)	Capital Outflow	Econ. Aid	Sub-Total	Total	U. S. Military Aid
1946 —	$4.3	$2.1	$0.4	$6.8	$0.9	$0.4	$2.7-b	$2.2	$6.7	$13.0	$ —
1947 —	5.3	2.4	1.0	8.7	0.8	0.5	3.9-b	1.8	7.0	15.7	0.1
1948 —	7.1	2.4	0.9	10.4	0.7	0.7	0.9	3.7	6.0	16.4	0.4
1949 —	6.6	2.4	0.6	9.6	0.5	0.6	0.7	5.1	6.9	16.5	0.2
1950 —	9.0	2.6	1.3	12.9	0.4	0.6	0.2	3.5	4.7	17.6	0.6
1951 —	10.8	2.7	1.1	14.6	0.8	1.1	0.2	3.0	5.1	19.7	1.4
1952 —	10.5-e	3.0	1.0	14.5	1.0-e	1.7	0.5	2.1	5.3	19.8	2.6
1953(a)—	11.0	2.8	0.7	14.5	1.1	2.2	0.3	1.9	5.5	20.0	4.7

Note: U. S. military aid does not generally increase the supply of dollars available abroad and therefore has been listed separately. (a) Estimated, Jan.-June data at annual rate; (b) Excluding capital furnished to the World Bank and to the International Monetary Fund; (c) Including interest and dividend payments to foreigners; (d) Including private remittances; (e) Estimated.

of U.S. Government spending, are in a basically vulnerable position.

Who Gained the Dollars?

What countries are getting all these dollars and gold, and when will their reserves be considered adequate to permit liberalization of foreign exchange and trade regulations? As to the gains in reserves, examination of the second table shows that the leading gainers have been the industrial countries of Western Europe; these together with Japan have been the chief beneficiaries of U.S. Government spending. The United Kingdom, which previously lost gold and dollars heavily, has recouped a good deal of the loss. On the other hand, the raw material producing countries which provide a market for the industrial nations have not generally been gaining.

With the exception of Venezuela, Colombia, and a few others, the gold and dollar holdings of most of the Latin American countries have about held even. Much the same is true of the raw material producers of Asia. The failure of these countries to add to their reserves has been due in part to the deterioration of their terms of trade, i.e., the relation between their export prices and their import prices; compared with 1951, a greater volume of exports is now required to pay for the same quantity of imports. But their main difficulty in balancing their international payments has been unsuitable internal financial policies. Some of them are determined to push their economic development too fast; others have been postponing the steps that would lower production costs as a prerequisite to stimulating the flow of exports.

The Dominion of Canada, whose gold and dollar holdings reached a peak in the summer of 1952, presents a special case. The Dominion's deficit on merchandise and service accounts with the United States has been running at an annual rate of about one billion dollars. But while this deficit was more than counterbalanced in 1952 by a large inflow of American investment capital and by Canada's large merchandise export surplus with countries other than the United States, the offsetting factors have weakened in 1953. Not only has the flow of American investment capital slackened, but Canada's exports have experienced the same narrowing of foreign markets that has affected U.S. exports.

Special pressure is developing in the case of Japan. Growing vigorously after the outbreak of the Korean war, Japan's gold and dollar holdings reached a postwar peak of $914 million as of March 1953. But the falling off in Japanese exports to the raw material producing countries and to the overseas sterling area in particular has resulted in a payments deficit toward these countries. This deficit is being met by drawing on the surplus earned in Japan's payments with the dollar area. Since this dollar surplus is dependent upon abnormal U.S. military spending – estimated at about $25 to $30 million a month – Japan is skating on thin ice.

Germany and Britain, the Largest Gainers

The largest gain of gold and dollars since the spring of 1952 has accrued to the London gold and dollar pool of the sterling area, whose reserves rose from the low point of $1,662 million as of April 30, 1952 to $2,367 million as of June 30, 1953. However, the slow pace at which these reserves are being rebuilt has been disappointing to the British, who had looked forward to possible early free convertibility of the pound sterling. Their hopes were supported by an improvement in the relationship of export prices to import prices– the converse of the change in the terms of trade of the commodity producers – and by lower expenditures for imports.

The offset to this improvement is the halt in the post-Korean expansion of international trade. Between the drop in the purchasing power of raw material producing countries and the competition offered by Germany and Japan, British exports have made poor progress, particularly in non-sterling markets. At the same time the sovereign sterling area countries, whose demand for dollars must be honored by London as the banker of the sterling area, are experiencing the same balance of payments difficulties as other raw material producers, and for the same reasons.

The second largest gainer of gold and dollars has been Western Germany, whose reserves have more than doubled since the spring of 1952. These gains reflect primarily the great strides that the German economy made in the five years since the currency reform of 1948, though U.S. economic aid, American troop spending, and other American outlays have helped. The maintenance of a free market economy made Germany quickly responsive to the world trade opportunities that developed after the outbreak of the Korean war, and this same flexibility has allowed her to maintain and even expand her exports in the last year or so after the general expansion of international trade came to a halt.

German gold and dollar reserves, now approaching the billion dollar level, had to be built up from virtually nothing. The reserves are needed as backing for Germany's foreign trade, and if she had not earned them some artificial measures would have been necessary to afford

protection against possible fluctuations in her balance of international payments.

The comeback of Germany contributed to the expansion of Dutch transit trade and thus to the rapid rebuilding of the gold and dollar reserves of the Netherlands. The main reason for the Netherlands' gains, however, was the courageous action taken in the spring of 1951 to halt inflation. The country managed to effect drastic internal retrenchment with hardly any repression of foreign trade; her external payments position improved and there was a return of confidence in the guilder.

Gold and Dollar Assets of Selected Countries

(In Millions of Dollars)

	Sept. 1949	March 1952	Dec. 1952	May 1953	Change: Mar. 1952-May 1953
Canada	$1,277	$2,206	$2,301	$2,155	— 51
Sterling Area:					
United Kingdom	1,425	1,700	1,846	2,321-a	+621
Australia	109	151	160	175-e	+ 24
India	308	293	312	339	+ 46
New Zealand	38	36	36	36-e	——
Pakistan	41-e	51	52	52-e	+ 1
South Africa	127	178	194	208	+ 30
Western Europe:					
Austria	45-e	60-e	101	127	+ 67
Belgium	842	756	830	824	+ 68
France	690	824	916	828	+ 4
Germany	148	390	691	855	+465
Italy	542	638	655	659-e	+ 21
Netherlands	338	490	747	849	+359
Portugal	232	316	343	376	+ 60
Scandinavia (b)	308	500	537	557	+ 57
Switzerland	2,044	1,977	2,064	2,058	+ 81
Latin America:					
Argentina	889	457	407-e	421-e	— 36
Brazil	462	417	390	435	+ 18
Chile	101	102	121	134	+ 32
Colombia	100	157	198	208	+ 51
Cuba	479	609	515	565-e	— 44
Mexico	222	357	376	360-e	+ 3
Uruguay	222	294	301	309	+ 15
Venezuela	484	453	532	572	+119
Africa and Asia:					
Belgian Congo	65	118	184	208-c	+ 90
Egypt	112	301	234	228	— 73
Indonesia	205	421	296	266	—155
Japan	165-e	694	824	900-e	+206
Philippines	349	339	324	335	— 4
Thailand	120-e	234	294	305	+ 71
International Institutions (d)	3,244	3,352	3,646	3,696-f	+344

(a) U.K. holdings as of June 30, 1953 reported at $2,367 million; (b) Denmark, Norway, Sweden; (c) March 1953; (d) World Bank, International Monetary Fund, Bank for International Settlements, United Nations and other international organizations; (e) partly estimated; (f) April 1953.

As will be seen from the table, Belgium, Switzerland, Portugal, Sweden and Austria have also added to their gold and dollar holdings. French reserves have been strengthened by occasional grants of cash and also by an Export-Import Bank loan which anticipated future U.S. payments for military equipment purchased in France. But the gap in France's external payments has been too wide, and the reserves have hardly held their ground.

When Are Reserves Adequate?

Some disappointment has been expressed because foreign countries, despite the considerable rise in their gold and dollar assets, have been slow to lift restrictions on the spending of dollars and have chosen to build up reserves rather than buy some of our surplus commodities. It has been noted that last spring's talk of a number of currencies getting on a freely convertible basis not only has died down but virtually died away, although such steps had been looked forward to eagerly as a means of expanding the international exchange of goods.

The question has been raised as to just what level of reserves a country must attain before it can consider making a dash for convertibility. How high must gold and dollar reserves go before a country can feel safe in dismantling its foreign exchange and import restrictions?

In a recent report on the adequacy of monetary reserves made at the request of the Economic and Social Council of the United Nations, the International Monetary Fund has attempted to formulate as much of an answer as can be given to these questions. "Adequacy of reserves depends on the prospective problems that confront the country, and, therefore, will differ from country to country and from problem to problem," states the Fund in its analysis; and it adds:

> No amount of reserves can be adequate to finance a chronic or continuing imbalance in a country's payments. The problem of reserve adequacy can be discussed meaningfully, therefore, only in the case of countries prepared to take appropriate measures to balance their external accounts over an entire cycle . . .

This fundamental assumption of strong and balanced payments positions, the Report points out, is not generally or even widely met at present. Some countries, it continues, are holding exchange rates at unrealistic levels, while others have been so concerned to assure full employment or rapid economic development that their monetary policies have been too expansionist to enable them to bring their international payments into balance without severe exchange and import restrictions.

The Report goes on to suggest that the whole pattern of world trade may now require larger reserves:

> The possibility of a downward swing in the demand for a country's exports increases its need for reserves and makes any given reserve holding less adequate.
>
> There is some reason to believe that world trade is more volatile and the exports of most countries more vulnerable to sharp downward swings now than was the case in 1938.

This opinion is based on the supposition that economic conditions in the United States before the war "were generally subject to greater variation than those in most industrial countries."

Since the U.S. now accounts for 15 per cent of world imports, compared with 10 per cent in 1938 and 13 per cent in 1928, any reappearance of sharp fluctuations in the U.S. economy would tend to have correspondingly more serious effects on world trade.

The latest annual report of the Bank for International Settlements in Basle also considers the problem of reserve adequacy. It finds that the gold and net foreign exchange holdings of countries other than the United States at the end of 1952 "stood in about the same proportion to the value of their annual imports — some 30 per cent — as they had done in 1913 and 1928". But the Bank believes that the ratio in 1928 was too low and warns in addition that reserves must be expected to fluctuate more widely than in the past. The internal adjustments normally set in motion under the rules of the gold standard, the Bank finds, are now relatively unreliable because central banks act less decisively and have to contend with the increased rigidity of wages and costs.

Moreover, the international credit system is not functioning as smoothly as it once did. In the old days even minor changes in interest and exchange rates used to produce a flow of short-term credit capable of smoothing over the temporary dislocations in a country's international payments. These short-term credit movements supplemented the reserves and made it possible for the world to get along with relatively little gold prior to the First World War. Not only have short-term capital movements of this type now virtually ceased, however, with movements of gold taking their place, but the short-term capital flows that have occurred since the 'thirties have often been of a disrupting rather than of a smoothing character.

It is generally agreed that the countries outside the United States need as a group more reserves than they are now carrying. Where the real difference of opinion arises is on how much additional reserve is required, and how it can be built up. As to the latter, the natural way is through the earning of surpluses in the international exchanges. This implies a willingness on the part of countries experiencing balance of payments difficulties to make the adjustments and accept the disciplines necessary to rectifying and improving their position. Unless such countries give heed to these basic considerations, as stressed by the Monetary Fund, neither a doubling or trebling of their reserves will suffice to maintain convertibility.

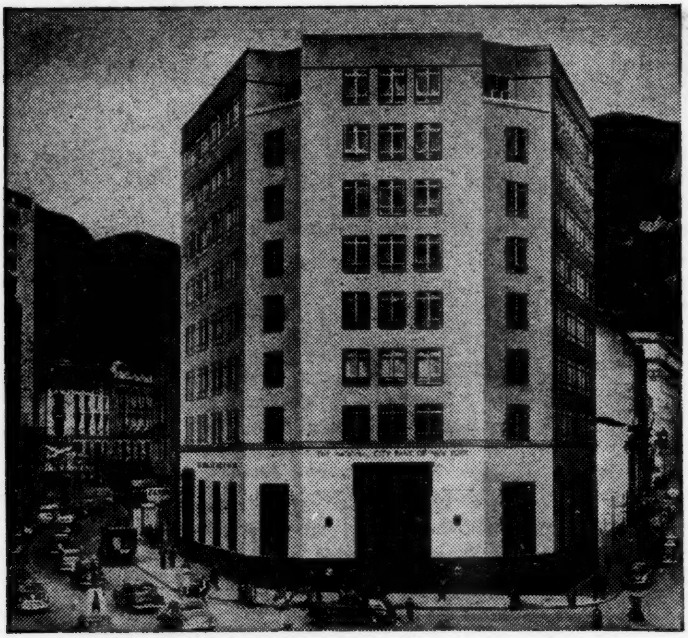
It might be remembered in this connection that in addition to the reserves held by individual countries there exists in the Monetary Fund a pool of gold and convertible currencies totaling more than $3.2 billion. Commenting on this substantial sum, Ivar Rooth, Chairman and Managing Director of the Fund, in a speech before the International Chamber of Commerce last May stated: "Opinions may vary about the amount of supplementary reserves necessary to support general convertibility but $3.2 billion is certainly a large part of what will be needed for this purpose."

Fears for the Future

Finally, there are reasons beyond those mentioned above why foreign countries, especially those of Western Europe, are likely to be cautious in spending their newly acquired gold and dollars. With the period of economic aid and other heavy U.S. Government outlays gradually coming to an end, Western Europeans realize that the bulk of their future dollar supply will have to be earned through private business transactions. They are therefore concerned over what they interpret as signs of reviving protectionist sentiment here, and are equally concerned about their ability to earn dollars if business in the United States declines from its present level.

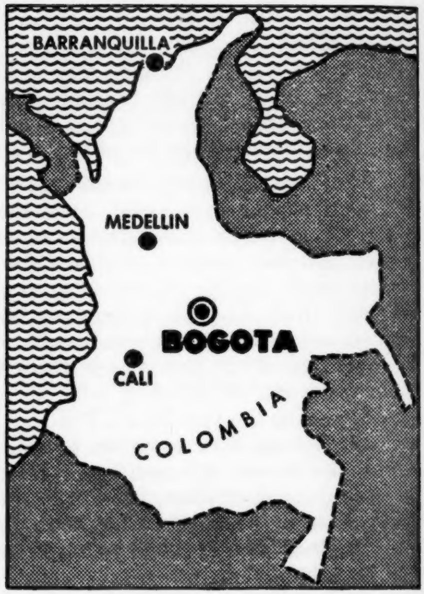
Now that the temporary effects of the Korean War are wearing off, Western Europe is also worried about its fundamental position in the world economy. European overseas investments are greatly reduced from prewar, and other invisible earnings are down. Thus Western Europe's success in paying her own way will depend primarily on the expansion of her exports of industrial products. These products will have to be sold in a world that has made a fetish of industrialization and that has not only become accustomed to turn to the dollar area for manufactures but also for such products as petroleum and nonferrous metals. To earn sufficient dollars in trade transactions with us or with other parts of the world will require both an expanded volume and a long-term change in the composition of exports.

Meanwhile, Western Europe may have to fall back on the gold and dollar reserves which we are now helping her to build up.



New Bogota Branch building at Avenida Jimenez de Quesada 8-89

National City's Bogota Branch Moves to New Quarters



NATIONAL CITY's Bogota Branch moved to its brand-new building on July 15—just across the street from where the Bank first opened its Bogota Branch 33 years ago.

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